ACCOUNTING FOR SUSTAINABILITY: IT'S TIME FOR CFMS TO LEAD THE CONVERSATION

BY EDWARD JOHNSTON
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Regardless of industry sector, size, or location, businesses throughout the construction supply chain must contemplate their position in the sustainability discussion. Will your company lead or follow?

If you’re wondering how a finance professional could take the lead in helping a company become more “green,” you (and your company) may already be well behind in remaining competitive, enhancing future bid opportunities, and realizing stronger margins than your competitors.

Before determining if there’s a place for sustainability in your company’s business model, several questions must be addressed:

• Where does sustainability fit within your business environment?
• Does your team believe that the precepts of sustainability apply to your company?
• What is sustainability anyway, and is it truly something that needs to be on the table for busy management teams?

This article will present an overview of sustainability and recent trends, the business case for considering a sustainability strategy, and ways to help determine your company’s readiness to educate, train, and promote a cultural change to embrace this movement.

What Is Sustainability?

More than “green,” sustainability is the economic, environmental, and social impact on the communities in which we work. It can be defined as a business’s ability to endure and be mindful of the greater impact of activities on the world in which it operates.

Over the past 20 years, the phrase “triple bottom line” has gained traction to specifically describe how the social, environmental, and financial components of business are becoming critically interwoven.
REALIZING THAT SUSTAINABILITY plays a role in RISK management, COST reduction, REVENUE growth, or EMPLOYEE DEVELOPMENT will highlight the BOTTOM LINE IMPACT of sustainability business drivers.

To build the complete foundation for this discussion, people, the planet, and profit stand as the “three pillars of sustainability.” Even more recently, discussion of a quadruple bottom line has begun to emerge as “future generations” demonstrate the requisite long-term nature of sustainable actions.

The demand for corporate transparency on sustainability in the U.S. is growing. The core of this trend takes many forms, from distinguishing companies that became part of Fortune’s “Change the World” list to identifying those that are champions of such external accreditation systems as LEED, Envision, or Living Building Challenge. For our industry, it is akin to stacking our departments with Certified Construction Industry Financial Professionals (CCIFPs)!

CONTRACTOR & EMPLOYER SELECTION

Embracing sustainability will increasingly drive the award of projects as both public and private owners look to contractors to help address both natural and societal concerns. Rich Goode, Executive Director of Ernst & Young’s Climate Change and Sustainability Services, increasingly hears clients say that “sustainability-related issues like energy reduction targets or a green supply chain have gone from nonissues to the top 10 or even top five decision criteria when selecting a vendor.”

And, as the more environmentally aware (i.e., Millennials) enter the workforce, sustainability will distinguish where extremely talented young job seekers choose to spend their careers.

Reflecting on companies that are struggling to attract and retain Millennial employees, Rich Goode provides insight into the minds of a population that “…think differently about the environment and feel that ‘doing the right thing’ for the planet is not a negotiable item. They simply will not work for a company with a poor, or no, reputation or strategy for sustainability. For growing companies, this is a real concern.”

INVESTOR INTEREST

Integrating corporate sustainability performance into the investment analysis process is similarly gaining momentum. No longer confined to values-based investors, mainstream institutional investors recognize the materiality of key sustainability issues that impact a company’s financial performance, valuation, and future risks and opportunities. As a result, investors are seeking more useful information than current sustainability reporting provides.

Once sustainability initiatives are integrated with corporate strategy and become part and parcel of the corporate mindset, the paradigm will shift from a sustainability strategy (i.e., discreet initiatives and tactics) to a sustainable strategy (i.e., a coherent plan to balance long-term viability – for the benefit of both shareholders and society – with demands for short-term competitiveness and profitability).1

CFMs have an opportunity to play a pivotal role in their company’s capital planning, as investors naturally gain more comfort from finance peers than they might from a generic discussion of the impact of global warming on a business value chain. Communicating your intentions in this area often reaps tangential benefits, such as improved employee morale and enhanced corporate reputation.

Sustainability Accounting Standards Board

The Sustainability Accounting Standards Board (SASB) is leading the effort to improve and standardize corporate disclosures on material sustainability issues. Produced by an independent, nonregulatory organization, the SASB’s industry-specific standards address a narrow set of sustainability issues, which are likely to have material impacts on a typical business sector. These standards also provide guidance in selecting metrics designed to communicate company performance.

“The result,” says Bryan Esterly, the Infrastructure Sector Analyst at SASB, “is a cost-effective corporate reporting tool that yields comparable, decision-useful information on key sustainability topics that help drive economic value – in other words, exactly what the investor community is looking for in corporate sustainability disclosures.”

SASB has released Provisional Standards for 79 industries, including Engineering & Construction Services (one of eight industries within the Infrastructure Sector).2 While the SASB Accounting Standards for Engineering & Construction are not mandatory, the standards are applicable to mandatory regulatory filings (like the SEC).
These standards also contain sustainability disclosure topics and accounting metrics. Sample topics include incidents of noncompliance with environmental regulations, safety and rework-related expenses, backlog for hydro-carbon related projects and renewable energy projects, etc.

**The Business Case for Sustainability**

By 2030, almost $90 trillion in additional global infrastructure capacity will be needed, and humankind will require 35% more food, 40% more water, and 50% more energy. Also, 195 countries recently agreed to lower greenhouse gas emissions to an extent that will allow only 20% of total current fossil fuel reserves to be burnt unabated.

The Genuine Progress Indicator (GPI) may begin to replace the Gross Domestic Product (GDP) as the key metric for measuring economic growth, and companies may be forced to reflect the cost of pollution created in their value chain either directly through taxes or indirectly in expanded financial statement reporting.

Have you considered capital investment changes to ensure that your company can meet the needs of a warmer, more extreme environment? Are you planning for possible cost implications within your respective organizations and supply chains? Can you envision running your business at zero net carbon?

“How sustainability impacts companies varies widely by industry,” according to Bryan Esterly. “SASB’s standards can help narrow the focus on the industry-specific issues that investors are most likely to be interested in, as issues contained in the standards already have a significant body of evidence that demonstrates their actual or potential impact on company value.” (See SASB’s Materiality Map a few pages ahead.)

For most companies, the results of embarking on the sustainability journey are well worth the investment. In fact, a 2014 National Bureau of Economic Research study of more than 175 companies and their results of operations over 18 years concluded that “high sustainability companies perform better when considering accounting rates of return, such as return-on-equity (ROE) and return-on-assets (ROA).” As various functional teams collaborate on sustainable initiatives, many see increased innovation and reduced waste.

Sustainability becomes a progression of values that embraces much of what is important to investors, employees, and companies throughout your supply chain. Ultimately, it is yet another component to strengthening a company’s financial P&L.

**What Is the Role for CFMs?**

Actively embracing a deep-rooted sustainability agenda within the accounting and finance province is a natural fit to:

- Build brand value to recruit and retain top talent;
- Strengthen public perception of your company as an ethical leader;
- Minimize exposure to environmental fines and regulatory compliance;
- Increase client satisfaction; and/or
- Reduce supply chain and material costs.

A sustainability-related agenda requires CFMs to considerably increase their interactions throughout their companies, using traits characteristic in the accounting and finance field: probing, inquisitive minds and the tenacity to convert operational performance, risk indicators, and forecasts to financial metrics with a healthy degree of professional skepticism. When delivered by financial professionals, sustainability reporting will be accompanied by the credibility and value that our trade offers.

As with any relatively new discussion, proceed with caution and do not exaggerate either benefits or risks. Be sure to maintain a perspective that pragmatically assimilates both values and value, lest you lose internal or external support as key stakeholders perceive your reporting as greenwashing your initiatives – nothing more than promoting an image of engagement.

While implementing sustainability initiatives does have short-term effects, the discussion better lends itself to a long-term perspective – building metrics that communicate how the contractor balances its impact on people, planet, and profit while playing an integral role in building a platform to deliver long-term sustainable financial performance.

Once CFMs understand the true influence of sustainability issues within an organization, they will be better able to guide senior executives in the long-term governance of the business.

**Understand the Language**

As CFMs begin to plan and conduct conversations to move their companies forward, the following terms, issues, and concerns will need to be addressed.

**Natural Capital**

Consider the environmental “bank” from which we draw material resources needed to build our projects. While some
EXHIBIT 1:
SASB Materiality Map™ for Infrastructure Sector
That Includes the Engineering & Construction Services Industry

SASB’s Materiality Map identifies sustainability issues likely to constitute material information on an industry-by-industry basis. To see all industries, visit materiality.sasb.org.

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Note: “Systemic Risk Management” is understood in the context of “probability of loss or failure to all members of a class or group or to an entire system.”

SECTOR LEVEL MAP
- Issue is likely to be material for MORE THAN 50% of industries in sector
- Issue is likely to be material for LESS THAN 50% of industries in sector
- Issue is NOT LIKELY to be material for any of the industries in sector

INDUSTRY LEVEL MAP
- NOT LIKELY a material issue for companies in the industry
- LIKELY a material issue for companies in the industry
core financial metrics are already in play, others are still being developed to inform strategic operational planning, and factor such diverse elements as the availability of raw material, potable water, or the impact of carbon emitted by a project.

Unfortunately, the creative development of measurement tools will be needed since, “on average, 60% of business and natural capital impacts and risks are embedded in supply chains,” therefore leaving our companies exposed to less-obvious risks.

“The ultimate bank on which we all depend – the bank of natural capital – is in the red; the debt is getting ever bigger and that is reducing nature’s resilience and considerablyimpeding her ability to restock. It leaves us dangerously exposed.”

As awareness grows, governments respond by forcing companies to address the impact of their activities on their local environment. For example, landfill taxes (including gate fees) range from as low as $2 per ton in the U.S. to almost $200 per ton in the Nordics. It is only a matter of time before CFMs will be forced to factor these costs into business forecasts.

Social & Human Capital

These are the people with whom we interact and rely upon in our businesses; they are supported through in-house training programs or an organization’s community-based initiatives. The lack of a determinable market value of social, human, or intellectual capital often results in an underinvestment in the very resources that ensure a company’s viability.

As with natural capital, considerable discussion will ensue when addressing or attempting to measure social and human capital, as placing a value on what is perceived to be invaluable requires subjective evaluation by the person performing the measurement, as well as accounting for the judgment of those who produce the social capital when measuring the benefit derived.

Regardless of the difficulty in measuring the impact of corporations’ activities on society, recent trends are moving away from inwardly facing P&L evaluations and toward an inextricable link to the society within which it operates. Sustainable businesses factor for the jobs provided and economic stimulation generated by their operations.

Integrated Reporting

Beyond a company’s balance sheet or P&L statement, integrated reporting encompasses the larger view of how its resources lead to value creation, using a frame of reference that includes the external environment as well as the measured organization. Such a mindset helps businesses develop more comprehensive strategies, managing a wider spectrum of risks while embracing concerns of a diverse stakeholder base and enhancing long-term corporate results.

Companies that utilize these reporting methodologies experience early improvements in collaboration with clients, enhanced data quality, and deeper internal engagement resulting in greater skills and respect for colleagues in varying departments. Investors tend to favor integrated reporting as it provides insight into the values and culture of the business while demonstrating how initiatives support each other and the long-term business plan.

As previously described, the SASB’s work is contributing to the growing integrated reporting movement. “The SASB standards serve as practical implementation of integrated reporting – while the standards are not an integrated report themselves, they are designed to serve as an input into existing corporate disclosure processes, thereby adding tremendous value to the integrated reporting movement,” says Bryan Esterly.

Identify & Address Sustainability Challenges

Insights into the challenges and rewards of embracing sustainability within your business model have been identified a few pages ahead in the Accounting for Sustainability Project (A4S). Primary among the challenges that the A4S has identified include:

- The long-term nature of addressing sustainability concerns, without a predictable timeline for demonstrable results;
- The need for collaboration across business functions;
- That control over the actions that drive results often resides outside your organization; and
- The disparate nature of preferences, responses, and requirements among customers, regulatory agencies, and other outside stakeholders when viewing your company’s sustainability platform.
With these challenges in mind, where should you start?

Benchmark Your Company

In order to gain a comprehensive perspective, first benchmark your company’s level of sustainability maturity and consider its next steps in embracing this imperative. Identify risks found in sustainability models that relate to your business, understand and assess their potential effects on your organization, and move the discussion toward including these risks within senior management’s strategy and business plan models.

Include Sustainability in Strategic Planning

Incorporate sustainability goals into your company’s strategic planning and demonstrate the value that these goals bring to the business to foster support from all levels of the organization during both profitable and challenging economic climates.

Consider developing an Environmental Profit & Loss (EP&L) statement to assist in measuring and monitoring more comprehensive and holistic results of operations while building awareness of the importance of the environment to the long-term viability of your business.

By developing a consistent, integrated, long-term strategy that is communicated to both internal and external stakeholders, your business will provide the context within which its short-term and longer-term actions can be viewed. Addressing longer-term risks may well identify new business opportunities and reduce exposure to resource, pricing, or regulatory changes, while creating the landscape within which key performance metrics will be built.

Be sure to relate your long-term sustainability discussions to risk management, cost reduction, revenue growth, or employee development. For instance, encourage engineers to achieve LEED AP and Envision® Sustainability Professional (ENV SP) certifications, estimating departments to include these discussions within their tender protocols, and marketing teams to initiate discussions with prospective clients that impact the environment and community.

Realizing that sustainability plays a role in these domains will highlight the bottom line impact of sustainability business drivers.

Beyond LEED AP and ENV SP certifications, sustainability must be ingrained in the fabric of construction business plans, financial forecasts, and business development strategies. Be aware before embarking down this route: It represents a journey that will be engaging and fully-engrossing. Do not proceed halfheartedly.

Manage Sustainability Metrics

How should your company begin to measure and report sustainability metrics or develop internal activities supporting a sustainable business model? The SASB Materiality Map for Engineering & Construction, a few pages back, demonstrates the shift away from economic risks in general and toward environmental risks.

“SASB’s standards include an average of only five sustainability topics and 14 metrics per industry,” as explained by Bryan Esterly. “This greatly narrows the focus on the issues that matter most from an investor’s perspective, and it provides a valuable resource to companies striving to manage sustainability risks and opportunities, and improve the effectiveness of disclosures.”

As mentioned, a strong commitment will be required to execute a successful sustainability strategy.

In the experience of Jennifer Clark, Senior Vice President at Skanska, consider a few generalities when building a sustainable plan. “There is typically resistance in the beginning, and this is often due to lack of knowledge and understanding. Many people just get it, while others may need to become better informed. Colleagues need to know that they do not have to believe in climate change or global warming to reap the benefits of sustainability.”

Conclusion

Sustainability will be a source of distinction in future corporate analyses. In short, all indicators point to the need for financial experts to become thoroughly versed in the impact of sustainability on their business model.

CFMs who get ahead of the curve by embracing the move toward sustainable accounting and supporting their executive teams will ensure preparedness for the accompanying fiscal implications; they will position their companies as industry leaders.

Short-term decisions made with the long term in mind ultimately become part of a systematic and pragmatic approach to an integrated triple bottom line.
Endnotes


4. OECD; Dan Hammer, Center for Global Development.


8. HRH The Prince of Wales, Accounting for Sustainability Forum, December 2013.


ACCOUNTING FOR SUSTAINABILITY PROJECT

Founded by His Royal Highness (HRH) The Prince of Wales, the Accounting for Sustainability Project (A4S), leads with a vision of enabling CFOs to be better equipped with practical tools for building effective business cases; evaluating risks with economic, environmental, and social impacts; and making more informed decisions that will ultimately increase engagement and create growth opportunities.

Capital markets are similarly addressed within the A4S mission, which supports regulatory and reporting regimes that encourage change and embrace sustainability.

HRH The Prince of Wales has leveraged his charitable influence by forming ancillary organizations, the CFO Leadership Network and an Accounting Bodies Network, to create cross-border collaboration and strengthen each member’s sphere of influence when promoting sustainability.

A4S has also taken steps to collaborate with business schools, integrating business-related sustainability discussions within research and MBA studies, and has recently initiated its Global Leadership Network within the U.S.

Member companies within the A4S CFO Leadership Network have shared several other “top tips” for companies progressing along similar journeys, including to:

1) Drive innovative thinking and set targets based on senior level leadership;
2) Collaborate internally both within your organization and across the value chain; and
3) Highlight the financial benefits of sustainability by focusing on ROI, particularly when first bridging the gap with non-sustainability-minded operational colleagues.

Find case studies, a guide to integrated thinking, and other tools to stimulate sustainability discussions and assist in evaluating your company’s position at www.accountingforsustainability.org.

Kelly Gangotra (CFO of Skanska UK), Edward Johnston, and HRH Prince Charles at the A4S CFO Forum at St. James’s Palace, December 10, 2015. © Paul Burns Photography 2015, all rights reserved.
Among many companies within the construction community to embrace sustainable thinking, Skanska maintains a “color palette” in its journey toward what it refers to as Deep Green – the construction process and performance that yields a near-zero effect on the environment through reduced impact on energy, carbon, materials, and water consumption.

It is often easier to envision your place along a continuum than to attempt a specific calculated position while considering “next steps” in the sustainability campaign.

Within this approach, Skanska utilizes a project life cycle analysis to ensure a thorough pursuit of sustainable opportunities and “Green BIM,” intended to enable early and fast scrutiny of construction design at a low cost.

Such a perspective acknowledges the incremental approach required to build a successful, holistic platform from which a sustainability mindset could permeate a business.

Additionally, Skanska measures how its performance in areas such as safety, ethics, inclusion, and community investment contribute to sustainability. (See below.)

Within the color palette, the company begins by meeting legislative regulations and client requirements, progressively moving toward demonstrating thought leadership in sustainability by identifying profitable ways to sustainably impact the environment within which we work.

In social capital exchanges, we:

- Encourage core training for the next generation of construction experts (as through the ACE Mentor Program);
- Support local communities within which our businesses perform construction projects, with a view toward improving the standard of living of those affected by our work; and
- Take deliberate actions toward sensitizing colleagues to specific and unique initiatives of their client and stakeholder community.

It is indeed a journey, with colleagues joining all along the route and continually developing their sustainable knowledge base and skill sets.